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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE INVESTIGATION OF THE CONTINUED REASONABLENESS OF CURRENT SIZE LIMITATIONS FOR PURPA QF PUBLISHED RATE ELIGIBILITY (I.E., 1 MW) AND RESTRICTIONS ON CONTRACT LENGTH (I.E., 5 YEARS).	**CASE NO. GNR-E-02-1** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Scott Woodbury, Deputy Attorney General, and in response to the Notice of Investigation, Notice of Modified Procedure and Notice of Comment/Protest Deadline issued on February 5, 2002 submits the following comments.

Congress in 1978 as part of the National Energy Act and as part of a package of legislation designed to address the then prevailing nationwide energy crisis passed the Public Utility Regulatory Policies Act (PURPA). Its purpose was to encourage the promotion and development of renewable energy technologies as alternatives to fossil fuels and the construction of new generating facilities by electric utilities. PURPA requires that electric utilities offer to purchase power produced by cogenerators or small power producers that obtain qualifying facility (QF) status.

The rate to be paid for QF power is not to exceed the "incremental costs" to the utility of alternative electric energy. Under the implementing rules and regulations of the Federal Energy Regulatory Commission (FERC), the rate a qualifying facility receives for the sale of its power is generally referred to as the "avoided cost" rate and should reflect the incremental cost to an electric utility of electric energy or capacity or both, which, but for the purchase from the qualifying facility, such utility would generate itself or purchase from another source. PURPA and related FERC regulations provide that the rates for QF purchases (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and (2) shall not discriminate against qualifying cogenerators or small power producers.

FERC promulgated the general scheme and rules, but left implementation to the regulatory authorities of the individual states. Under FERC rules and regulations, published rates are required only for purchases from qualifying facilities with a designed capacity of 100 kilowatts (kW) or less. PURPA, however, does not prohibit the publishing of rates for larger projects. Reference 18 C.F.R. § 292.304(c). Requirements regarding length of contract are not specified by either PURPA or FERC's implementing regulations. Consequently, both of these issues are matters that lie within the Commission's discretion.

In comments filed in Idaho Power Company Case No. IPC-E-01-37, the J.R. Simplot Company petitioned the Commission to revisit and review two issues, i.e., (1) contract length and (2) the size of QF projects entitled to published avoided cost rates. Simplot asks that the Commission re-examine the basis for its decisions to set the required contract term at five years and to limit published rates to QFs smaller than 1 MW in size.

The Commission in its Order No. 28945 in Case No. IPC-E-01-37 found the issues of contract length and size limitation raised by Simplot to be important issues meriting a separate forum or docket for discussion. As a result, the Commission initiated this generic docket soliciting comments, Case No. GNR-E-02-01. On February 5, 2002, a Notice of Investigation, Notice of Modified Procedure and Notice of Comment/Protest Deadline was issued.

CONTRACT LENGTH

Background

The Commission's policy with respect to standard contract length has evolved over the years. From 1980 when PURPA was first implemented in Idaho, through 1987, utilities were

obligated to provide QFs with 35-year contracts. The reason for the 35-year maximum contract length was that 35 years was the amortization period allowed for similar utility-owned facilities. A contract length that agreed with the project's amortization schedule served to make financing easier, and in effect, helped encourage QF development.

In 1987 (Reference Case No. U-1500-170, Order No. 21630) the Commission shortened the standard contract length to 20 years reasoning that risk and uncertainty inherent in long-range forecasting increases dramatically with time and that a shorter contract term would reduce that risk. The Commission ruled that contracts longer than 20 years would be available to QFs only upon a persuasive showing of need.

Later, in 1996, the Commission again reexamined the issue of contract length. In Order No. 26576 in Case No. IPC-E-95-9, the Commission further shortened the required contract length from 20 years to five years for projects 1 MW and larger, based on the following reasoning:

> Significant changes have swept through the electric industry since we last examined the issue of contract length. The FERC has mandated open access to the transmission system, thermal technologies have improved, gas prices are low, there is a considerable surplus of energy available in this region resulting in very low spot market prices for electricity and, finally, even the continued existence of PURPA is being called into question. We find that as industry as a whole continues to a more free market model, we cannot justify obligating utilities to 20-year contracts for PURPA power. As the utilities in this case note, such an obligation does not reflect the manner in which they are currently acquiring power to meet new load; through short-term (five years or less) purchases. Consequently, it would be nothing more than an artificial shelter to the QF industry to provide those projects with contract terms not otherwise available in the free market. We can find no justification for insisting that Idaho's investor-owned utilities and their ratepayers assume such an obligation simply to foster one particular segment of an increasingly competitive industry. We find, therefore, that Idaho's investor-owned utilities shall not be required to offer contracts to QFs in excess of five years until further action is taken by this Commission. This rule, however, does not prevent utilities from offering for approval QF contracts with terms that exceed five years should the utilities believe that such contracts are in the best interests of their ratepayers.

In 1997, the Commission extended the five-year contract length limitation established for large QFs to smaller than 1 MW QFs as well. Reference Case No. IPC-E-97-9, Order No. 27111.

Shortly after approving Idaho Power's application to limit all QF contracts to five years, both Avista and PacifiCorp petitioned for and received approval to limit all QF contracts to five years Reference Case Nos. WWP-E-97-8, Order No. 27212; UPL-E-97-4, Order No. 27213.

Staff Analysis

The vast majority of QF contracts signed in Idaho since the implementation of PURPA have been for a term of 35 years. Attachment A shows that approximately 86 percent of the contracts have been for a term of 35 years, about 8 percent have been for 20 years, and only a single contract has been signed for a term of five years. Attachment A also shows the time and rate at which QF contracts have been signed over time. Clearly, most contracts were signed during the period from about 1983 through 1989. Only a couple of contracts have been signed since 1996. Most contracts will expire during the 2016 through 2023 time frame.

While most existing QF contracts are for 35-year terms, Staff does not wish to imply that long contract lengths have been the only reason for the intensity and timing of QF development. Avoided cost rates have decreased substantially since the first QF contracts were signed. In addition, the most favorable sites for QF development were developed early, leaving fewer attractive sites to be developed later. Nevertheless, it is undeniable that longer contracts have proven to be an incentive to QF development, and conversely, that very short contract length limitations have proven to be a barrier to development.

Staff acknowledges the complaints expressed by potential QF project developers that limiting contract lengths to only five years effectively precludes nearly any new project from being developed. Financing is nearly impossible to obtain with only a guarantee of a five-year revenue stream. Few, if any, projects are able to generate enough revenue to enable construction debt to be retired in five years or less.

In the earlier proceeding in which the Commission reduced required contract lengths from 20 to five years (IPC-E-95-9), Staff advocated maintaining the standard 20-year contract term. Staff contended that it was reasonable to require 20-year contracts for QFs since utilities' long-term acquisition planning is still primarily based on the acquisition of long-lived resources under long-term commitments. Staff reasoned that as long as the rates that utilities pay for QF power are based on the utilities' avoidance of planned resources, the utilities should be required to offer 20-year contracts if the planned resources have lives of 20 years or more. Staff believed

that although utilities were then relying on short-term market purchases to satisfy their short-term needs, the fact that their respective IRPs called for acquisition of long-term resources could not be overlooked and justified requiring 20-year contracts terms for QF projects.

Staff continues to believe that its earlier position has merit. Each of the utilities has either recently built new generation, is currently adding new generation, or plans to add new generation in the very near future. Idaho Power, for example, recently completed a 90 MW gas-fired plant at Mountain Home. The utility is also currently seeking Commission approval for a power purchase contract from a 250 MW gas-fired plant to be constructed by Ida-West near Middleton (IPC-E-01-42). The proposed contract for purchases from the plant is for a five-year term with options to renew the contract for any one or all of the five successive years. The contract also contains provisions to permit Idaho Power to purchase the plant after the initial five years, or alternatively after ten years. The plant itself is expected to have a useful life of 30 years.

Avista is in the process of completing the 280 MW Coyote Springs II plant. Avista Utilities will own and receive the output of half of the new plant. Avista is also finalizing construction of a small gas-fired plant called Boulder Park. The plant is located in the Spokane area and has a capacity of 25 MW. In addition, Avista is adding a combustion turbine with a capacity of 7 MW at its Kettle Falls plant. Along with the addition of new generation capacity, Avista has signed a market purchase agreement for 125 MW through 2006, and has proposed an additional 100 MW purchase for 2007-2010.

PacifiCorp is pursuing adding single-cycle gas turbines at its Gadsby site in Salt Lake City and at West Valley City in Utah to meet near term capacity constraints. The Company is also considering building a fourth coal unit at its Hunter plant in Utah.

It is certainly true that each of the utilities continues to make substantial purchases from the market under contracts five years or less in length. However, it is also true that each of the utilities has either already made, or is considering, long-term commitments for new generation. All of the new generation plants being built by the utilities will have useful lives in excess of 20 years. Because the utilities are making long-term commitments, there is no more danger that QF contracts will become stranded costs in the future than the utilities' own new generating plants.

Staff believes, however, that there are key differences between utility-owned plants and QFs that should not be overlooked. While utilities are making long-term commitments to new generating resources, most of those resources are dispatchable peaking or base load facilities with relatively low capital costs and avoidable variable costs. When it is not economical to operate utility-owned plants, they can be idled, saving fuel and other variable costs. With QFs on the other hand, utilities must continue to purchase their output regardless of whether cheaper power is available from the market or some other source. Under the current pricing methodology for QFs, the surrogate avoided resource used as the basis for calculating rates is a non-dispatchable combined cycle combustion turbine (CCCT). Therefore, no consideration is given to whether plants can be dispatched or not. While a twenty-year contract for QFs would be more consistent with utility-owned resources, a pricing methodology for QFs that fails to account for dispatchability may produce rates that are too high when compared to utility-owned resources. Staff believes that it may be appropriate to apply some discount to the published avoided cost rates for non-dispatchable plants. To do so, however, would require a Commission approved change to the existing methodology.

Staff Recommendations

Staff believes that the Commission should revise its rules to return to 20 years as the required minimum length for QF contracts. However, Staff believes that the Commission may wish to consider whether some adjustment to the current avoided cost rate calculation methodology is warranted to discount rates for QFs that cannot be dispatched by the utility. Staff believes this may be necessary in order to treat QF projects on an equal footing with utility-owned plants.

AVAILABILITY OF PUBLISHED RATES

Background

When PURPA was first implemented in Idaho, published avoided cost rates were made available to projects smaller than 10 MW. For projects larger than 10 MW, contracts were to be individually negotiated. However, even for these larger projects, published rates were still expected to form the starting point for negotiations. The utilities contended that these facilities,

because they represent a significant generating resource on each utility's system, require special operating and scheduling procedures. Reference Case No. P-300-12, Order No. 15746.

In 1989, utilities requested that published avoided cost rates be limited to facilities with capacities less than 1 MW rather than 10 MW. However, the Commission rejected the request and maintained 10 MW as the limit at which projects were eligible to receive published rates Reference Case No. U-1500-170, Order No. 22636. In 1995, in Case No. IPC-E-95-9, the Commission was again asked by the utilities to lower the threshold for published rates from 10 MW to 1 MW. This time, the Commission agreed, stating the following:

> There is a widely held expectation that there will be increasing competition within the electric utility industry. In light of that, we believe it is especially important that the QF industry be able to demonstrate that the energy resources it offers are as cost effective as those that a utility could construct. Ratepayers should be indifferent to whether a resource serving them was constructed by a utility or an independent developer. The cost and quality of service should be the same. Ratepayers should not be asked to subsidize the QF industry through the establishment of avoided cost rates that exceed utility costs that would result from an effective least cost planning process. Reducing the threshold correspondingly reduces the risks associated with the published rates being set either too high or too low. Pursuant to 18 C.F.R. 292.304(c), PURPA requires only that we establish and make available published rates for projects 100 kW (i.e., $1/10^{th}$ of 1 MW) and smaller. We believe that lowering the threshold, along with adopting a least cost planning methodology as discussed later, will help to ensure that a greater number of QF projects are cost effective by market standards before they are acquired by our utilities. By lowering the threshold to 1 MW, we are striking a reasonable balance between encouraging the development of independent, alternative technologies with the need to protect ratepayers from paying for resources which have not proven their cost effectiveness.
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> …
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> As of the effective date of this Order, only QF projects smaller than 1 MW will be entitled to receive the published, SAR-based rates. Rates for projects 1 MW and larger will be established using a least cost planning methodology, ... Reference Case No. IPC-E-95-9, Order No. 25884.

Staff Analysis

Approximately half of the QF contracts signed in Idaho since PURPA's implementation have been for projects smaller than 1 MW. Over 80 percent of the contracts have been for

projects smaller than 5 MW. Only three contracts larger than 10 MW have been signed, each of which is at existing industrial facilities (Potlatch, Simplot's Pocatello plant, and Boise Cascade's Emmett sawmill). Attachment B shows the size distribution for QF contracts in Idaho since 1980.

Staff believes that the level at which the Commission establishes the threshold for published rates is both a matter of accuracy and administrative convenience. The presumption seems to be that published rates reflect avoided cost rates that are too high, but as long as the rates are restricted to small projects, they are acceptable. At the time the 1 MW and larger methodology was adopted, it was acknowledged that the method was more complex than using published rates, but it was also generally believed to be a more accurate method of establishing rates. Since it was believed to be more accurate, it was reasonable to lower the threshold thereby making it applicable to a greater proportion of QF contracts.

The 1 MW and larger methodology is sound in principle, but the methodology was conceived with the assumption that a long term look at the utility's resource options was appropriate since the QF contracts were also assumed to be 20 years in length. Currently, with a contract limit of only five years, the methodology produces results that could be obtained more easily by simply obtaining market quotes for similar products.

While the 1 MW and larger methodology is relatively straightforward conceptually, it is fairly difficult to actually apply. Utilities must use complex, proprietary power supply models that can be perceived as "black boxes." Rate computations can be very time consuming. Furthermore, potential QF developers do not know in advance what the rate will be, making planning much more difficult. To date, no contracts have been signed with rates computed using the methodology.

The under 1 MW methodology is based on the assumed costs of a combined cycle combustion turbine. Since this is, in fact, the same type of unit some of the utilities are now pursuing, the rates computed using this methodology are nearly the same as the costs utilities are actually incurring to build new generation. There is no evidence at this time to indicate that the rates computed using this methodology do not accurately reflect the costs of a gas-fired CCCT when viewed over a twenty-year period.

Staff Recommendations

Staff recommends that the threshold for availability of published rates be increased to 5 MW. Staff believes that published rates are fair and reasonable, and accurately represent the costs of the surrogate avoided resource adopted by the Commission. As long as published rates reasonably reflect utilities' avoided costs, then there is little reason to restrict their availability to projects smaller than 1 MW. A threshold set at 5 MW would permit most projects to receive published rates, thereby reducing administrative complexity while still insuring a fair rate.

Staff further believes that a reduction in administrative complexity is sufficient reason to increase the threshold for published rates to 5 MW even if the minimum contract length is not increased to twenty years. However, if a five-year contract limit is retained, Staff believes that the methodology for projects larger than the threshold be changed from the current least cost planning methodology to a market based approach. Market prices for five years into the future are readily available, constantly updated, and would be easy to apply.

Respectively submitted this day of March 2002.

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